Deferring Loan Repayments (Moratorium): Think Before you Act

13 May 2020

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As the Covid-19 pandemic brings the Australian economy to a standstill, a severe drop in consumer demand is putting vast numbers of businesses at risk of bankruptcy, and millions of employees at risk of losing their jobs. A number of emergency stimulus measures have been introduced by Federal and State governments to help workers and businesses. One such intervention is an option of deferring loan repayments for up to six months, also known as a moratorium. A moratorium means a temporary hold on activity. Eligible small businesses can get a six-month break from making repayments on their loans under a coronavirus relief package announced by the Australian Banking Association (ABA). The Big 4 Australian banks along with other mid-tier banks have also announced that they will be freezing mortgages to provide similar assistance to their individual borrowers affected by Covid-19.

What does that mean for the borrower? There are lots of questions which are not clear to a borrower particularly one with no or minimal finance background. An attempt has been made through this article to provide an insight for borrowers to make a considered decision.

Not all banks are making the same arrangements regarding how they are implementing their moratorium schemes. Some banks are allowing their customers to pause the repayments for six months and then pay slightly higher monthly instalments later without extending the loan term. Others are allowing their customers to extend the term of their loan by keeping the same amount of monthly repayments.

One thing is clear. **A deferral does not mean a waiver – it must be paid later.** However, this is not all. During this payment holiday, interest will be capitalised and would continue to accrue. It would eventually be added to the remaining principal amount due when the crisis lifts. To understand this better, let's take an example:

Suppose you have a $400,000 remaining loan at an interest rate of 3 per cent. Because of COVID-19, you are facing financial hardship and decide to defer your loan repayments for six months. While you won't have to make any principal or interest payments for the 6 months, interest will continue to be accrued. In this case interest of $1,000 per month would continue to be added to the outstanding balance. Therefore, in six months' time, you will be looking at paying off a $406,000 loan. It can then be paid off over the life of the loan once repayments begin again, or the length of the loan can be extended. The impact of this on future instalments will depend on the arrangement with your bank.

1 Outstanding loan term (Months)	2 Instalment due before moratorium ($)	3 Instalment due after moratorium ($)	4 Extra amount due [(3-2)*1]($)	5 Extra instalment/s payable (approx.)
60	7,187	7,295	6,480	1
120	3,862	3,920	6,960	2
240	2,218	2,252	8,160	4
360	1,686	1,712	9,360	6

Amount in the second and third columns has been derived from the calculator on National Australian Bank Limited (NAB) Website.

The above table tries to explain the impact of the above deferral. As is clear, the interest ($6,000) accrued during this period will get adjusted either through higher amount of each instalment or through higher number of instalments payable during the repayment period.

If the loan is due 5 years in the future, you would need to pay an extra $108 per month for the next 60 months to pay it off resulting in an additional payment of $6,480. In case the loan is due 20 years in the future, an extra $34 per month for the next 240 months would be required to pay it off resulting in an additional payment of $8,160.

However, if you negotiated with your bank to continue paying the same instalment amount, then you would end up paying extra instalments as shown above. In the above example with the loan due in 5 years, you would end up in paying one extra instalment. However, if the remaining term is 20 years, you could end up in paying four extra instalments.

My advice: If you can repay the instalments, you should consider paying them now. Availing the option of a moratorium could put an additional burden on you. If you have the means, continue with paying your instalments as also advised by the ABA.

What I am suggesting here is that there is no one size fit all model for this situation. Take a considered decision before deferring your loan repayments. Consider consulting a financial expert for more detailed modelling of your financial circumstances.

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